

November 09, 2021

Bandhan Bank Limited: Ratings reaffirmed and outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Subordinated Tier II NCD	160.00	0.00	[ICRA]AA reaffirmed and withdrawn; Outlook revised to Negative from Stable
NCD Programme	196.40	196.40	[ICRA]AA reaffirmed; Outlook revised to Negative from Stable
Term Loans from Banks	80.00	80.00	[ICRA]AA reaffirmed; Outlook revised to Negative from Stable
Certificates of Deposit	3,000.00	3,000.00	[ICRA]A1+; reaffirmed
Total	3,436.40	3,276.40	

*Instrument details are provided in Annexure-1

Rationale

The revision in Bandhan Bank Limited's (BBL) rating outlook to Negative follows the sustained weakness in its emerging entrepreneur business (EEB) portfolio despite the improvement in collections in Q2 FY2022. The gross stress pool in the EEB segment (GNPA + gross restructured + SMA¹ 1 + SMA 2) increased to Rs. 19,457 crore, or 36.0% of the EEB portfolio as on September 30, 2021 compared to Rs. 15,657 crore, or 29.4% as on June 30, 2021. However, if the SMA 0 book is included in the stress pool, then there is a reduction to Rs. 25,456 crore, or 47.1% of the EEB portfolio as on September 30, 2021 from Rs. 28,746 crore or 54.0% as on June 30, 2021.

While the bank continues to collect in the above mentioned stressed portfolio, the uncertainty over the quantum and timing of the final recovery has prompted the bank to accelerate the provision for the entire pool of stress in the EEB segment. The bank held 49% provision on its gross stress pool of Rs. 19,457 crore as on September 30, 2021, which is based on expected collections from the portfolio till March 2022 and the expected and estimated recoveries under various government schemes. ICRA notes that BBL witnessed collections of around Rs. 1,000 crore in October 2021 from the stressed assets and targets to collect Rs. 6,000 crore by March 2022. In addition, the bank is targeting a recovery through the Credit Guarantee Fund for Micro Units (CGFMU) scheme of Rs. 3,000 crore, apart from likely recover from the Assam Microfinance Incentive and Relief Scheme (AMIRS), but the value is not ascertained yet.

With accelerated provisions during Q2 FY2022, the bank reported net losses during the quarter, while the Tier I capital ratio declined to 19.48% as on September 30, 2021 from 23.85% as on June 30, 2021. The high level of provision on the stressed pool of assets (including standard accounts) provides some comfort. However, the ability of the bank to reduce its stressed pool of assets, either by recoveries from borrowers or through various government schemes, will continue to drive future credit provisions, profitability and capital.

BBL benefits from its strong liquidity profile supported by its steadily increasing deposit base and the high share of the priority sector lending (PSL) compliant portfolio. Further, the deposit profile is supported by a high share of retail deposits to total deposits of 83.99% as on September 30, 2021.

¹ Special mention accounts (SMA) are overdue loans with SMA 0 reflecting an overdue status of up to 30 days, SMA 1 reflecting an overdue status of 31-60 days and SMA-2 have overdue status of 61-90 days

ICRA has withdrawn the rating on BBL's Rs. 160-crore Subordinated Tier II non-convertible debentures (NCDs) as the same have been fully redeemed and there is no amount outstanding against the rated instrument. The rating has been withdrawn as per ICRA's policy on the withdrawal and suspension of credit ratings.

Key rating drivers and their description

Credit strengths

Long track record in microfinance segment and high share of PSLs aid better profitability – The bank has a long track record in the microfinance industry and has operational experience of more than two decades. The bank's ultimate parent company, Bandhan Financial Services Private Limited (BFSL), was earlier operating as microfinance lender before it was converted to a bank. Consequently, the bank has high customer vintage, loyalty and a strong connect with its micro loan customers. It has demonstrated resilient asset quality during credit events such as demonetisation and the Assam agitation. However, the Covid pandemic has severely impacted the debt servicing ability of the borrowers and, hence, the asset quality of the bank.

While the bank has diversified into secured lending through its merger with GRUH Finance Limited in FY2020, the microloans (or EEB segment) continue to account for 66.2% of its loan portfolio. The bank has a high share of a PSL-compliant portfolio, which enables it to sell priority sector lending certificates (PSLCs). PSLC income is a significant contributor to the overall non-interest income (NOI; 34.7% of total NOI in FY2021), which supports the bank's RoE and internal capital generation. However, this source of income may be vulnerable to any unfavourable regulatory development on PSL norms for banks and the improved ability of other banks to organically grow their PSL, which could reduce BBL's income from such transactions.

Strong capital position despite accelerated provisions for stressed assets; ability to meet targeted recovery from stressed pool and various government schemes available on stress pool remains monitorable – The bank reported a Tier I capital ratio of 19.48% as on September 30, 2021 which declined from 23.85% as on June 30, 2021 because of losses in Q2 FY2022. The capital position has also been supported due to its presence in the high-yielding EEB segment, translating into robust NIMs and strong profitability. While BBL's operating profitability is strong, its presence in the micro loan segment with a marginal borrower profile exposes the net profitability to episodic events like floods and political/socio-economic instability, which lead to higher credit costs. Covid-19 impacted the EEB borrower segment and despite the improvement in collections in Q2 FY2022, the stressed EEB portfolio remained elevated as on September 30, 2021.

The bank had a provision cover of 49% for the identified pool of stressed EEB portfolio as on September 30, 2021. The bank expects the credit provision to normalise on hopes of improved collections from the EEB portfolio and recoveries under various government schemes. Accordingly, the bank expects no further losses and impact on its capital because of the existing pool of stressed assets. However, as the net stress assets in relation to the core equity capital remains high at 87.5% as on September 30, 2021, the ability of the bank to reduce its stressed pool of assets, either by recoveries from borrowers or through various government schemes, will continue to drive future credit provisions.

Strong liquidity profile driven by steadily growing deposit base and higher share of PSL-compliant portfolio – Though collections have remained below the pre-Covid level, the bank has been able to maintain a strong liquidity profile largely supported by its healthy deposit base and PSL-compliant portfolio. Deposits grew at a CAGR of ~36% during Q2 FY2017 to Q2 FY2022 to Rs. 81,898 crore as on September 30, 2021. Within deposits, the share of retail deposits (CASA + retail term deposits) to the total deposits increased to 83.99% as on September 30, 2021 compared to 76.92% as on September 30, 2020. Also, the share of CASA deposits increased to 44.6% of the total deposits as on September 30, 2021 against 43.4% as on March 31, 2021. The deposit costs have consistently declined with the cost of interest-bearing funds falling to 5.4% in Q2 FY2022 from 6.5% as on Q2 FY2021.

The bank's liquidity is supported by a high share of PSL and a PSL-compliant portfolio, which supports its ability to generate liquidity. BBL can avail refinancing facilities from All-India Financial Institutions (AIFIs) against its PSL portfolio, which depends on its net worth and the net worth of the lending AIFI. BBL can also sell these PSL portfolios through interbank participatory

certificates (IBPCs), which can generate liquidity, if required. Notwithstanding these short-term liquidity enhancers, the stability and steady growth in the deposit base will drive liquidity in the long term and will remain a monitorable.

Credit challenges

Asset quality under pressure due to pandemic given the presence in marginal borrower profile segment - As expected, Covid-19 has adversely impacted the bank's asset quality with gross NPAs of 10.82% as on September 30, 2021 (1.48% as on March 31, 2020). The asset quality deteriorated on account of higher slippages. The bank witnessed fresh NPA generation of 11.7% (annualised) in H1 FY2022 and 10.4% in FY2021 because of the first and second wave of Covid-19. Further, BBL had a gross restructured portfolio of 10.3% of gross advances, of which the restructured EEB portfolio stood at 8.5% of the gross advances as on September 30, 2021. In addition, the bank's EEB portfolio reported high overdue book in the SMA 1 and SMA 2 categories of 7.1% and 2.5% of the gross EEB book, respectively, as on September 30, 2021. Overall, the stress (gross NPA + gross restructured + SMA 1 + SMA 2) in the EEB book, which is unsecured and prone to higher loss due to defaults, remains elevated. The bank has a provision cover of 49% for the identified pool of stressed EEB portfolio as on September 30, 2021. ICRA notes that BBL continues to receive collections from the stressed assets.

The bank has availed cover under CGFMU, which provides coverage against credit losses to lenders against the payment of a guarantee premium (~1%) with maximum losses capped at 15% of the disbursement amount. Based on this, the bank expects to recover Rs. 3,000 crore from the scheme and the guarantee is likely to be recovered post FY2022. Additionally, the bank is likely to receive payment under AMIRS as an estimated ~14% of its portfolio is in Assam with 24.3% of the loans in this state turning non-performing as on September 30, 2021.

Based on the above estimates, the bank believes it has sufficiently provided on its stress pool of assets. However, in ICRA's view, the ability of the bank to reduce its stressed pool of assets, either by recoveries from borrowers or through various government schemes, will continue to drive future credit provisions, profitability and capital.

BBL's borrowers in the micro loan segment are among the weaker sections of society and are highly vulnerable to political appeasement. The bank will remain exposed to event risks and the losses upon default are expected to be very high, given the unsecured nature of lending.

High geographical concentration of loan portfolio - While BBL has increased its pan-India presence across 34 states and Union Territories (UTs), 57% of the banking outlets were in the eastern and northeastern regions as on September 30, 2021. Owing to the concentration of the branch network, the bank's advances have high geographical concentration in the eastern and north-eastern regions of India, specifically West Bengal (46% of MFI loans) and Assam (14%). Also, the retail deposits remain concentrated with the eastern and northeastern regions of India, accounting for ~55% of the total deposits. This exposes the bank to event risks and economic conditions, especially in these geographies. Meanwhile, GRUH is present in 11 states and one UT through 195 GRUH centres, most of which are in the western part of India. ICRA expects the portfolio concentration to continue in these regions in the medium term, given the size of the existing portfolio and the branch network.

Liquidity position: Strong

The bank reported a positive cumulative gap across all the maturity buckets as per the structural liquidity statement as on June 30, 2021. BBL's stable deposit profile, coupled with the short tenure of micro loans (12-24 months), largely supported its strong liquidity profile. BBL had excess SLR securities of ~Rs. 13,007 crore (16.1% of NDTL), as on July 2, 2021, that can be sold to meet its liquidity requirements. Additionally, the bank reported sizeable cash and bank balances of Rs. 12,844 crore, or 11.0% of the total assets as on September 30, 2021. Moreover, the bank's ability to avail refinance and undertake IBPC transactions, given that a large share of its portfolio qualifies for PSL, enhance its liquidity. BBL's daily average LCR remained high at 126% for Q1 FY2022 against the regulatory requirement of 100%.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Stable if the bank is able to reduce the net stressed asset portfolio (NPA + restructured + SMA1 + SMA2) below 3% of advances, improve profitability with RoA of >3% and maintain Tier I capital position above 20%.

Negative factors – ICRA could downgrade the ratings if the net stressed book (NPA + restructured + SMA1 + SMA2) remains elevated at > 5%, leading to continued uncertainty on asset quality, capital and profitability. A decline in the Tier I ratio below 15% will also be a negative rating trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Policy on Withdrawal of Credit Ratings
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financials of the BBL

About the company

Erstwhile Bandhan Financial Services Private Limited (BFSL) was the largest non-banking financial company-microfinance institution (NBFC-MFI) in India and the first entity to receive an in-principle universal banking licence from the Reserve Bank of India. Following the transfer of BFSL's business to the bank, Bandhan Bank Limited (BBL) commenced operations in August 2015.

BBL was incorporated in December 2014 as a wholly-owned subsidiary of Bandhan Financial Holdings Limited (BFHL). On August 3, 2020, BFHL diluted its shareholding in BBL to 40% to comply with the regulatory requirement on promoter holding in the bank. BFHL's stake was diluted to 82.28% upon the initial public offer by BBL in March 2018 and later to 60.96% upon the amalgamation with GRUH in October 2019. BFHL is now required to further reduce its shareholding in the bank to 15% by August 2027.

BFSL holds 100% equity in BFHL. BFSL's shareholders are Financial Inclusion Trust (FIT): 32.91%, Caladium Investment Pte Ltd: 16.7%, International Finance Corporation: 13.59%, IFC FIG Investment Company: 2.85%, Bandhan Employee Welfare Trust: 14.61%, SIDBI: 8.13%, North East Financial Inclusion Trust (NEFIT): 7.82%, and individuals: 3.4%. FIT and NEFIT are trusts formed in FY2009 with corpus donations from Bandhan Konnagar, the NGO from which the microfinance portfolio was transferred to BFSL. The beneficiaries of these trusts are the public and the trustees are industry professionals.

BBL has its headquarters in Kolkata and follows the group-based individual lending model for the microfinance business. In 2019, the amalgamation of GRUH (housing finance company) with BBL was completed. GRUH had presence in 11 states and one UT through 195 GRUH centres, most of which are in the western part of India. As on September 30, 2021, BBL had a network of 5,618 branches, banking units or doorstep service centres (DSCs) and GRUH centres, spread across 34 states and UTs.

Key financial indicators (audited)

Bandhan Bank	FY2020	FY2021	H1 FY2021	H1 FY2022
Net interest income	6,324	7,563	3,735	4,049
Profit before tax	4,053	2,949	1,968	-3,532
Profit after tax	3,024	2,205	1,470	-2,636
Net advances	66,630	81,613	73,307	74,487
Total assets	91,718	114,987	101,477	116,347
% CET I	25.19%	22.48%	22.20%	19.48%
% Tier I	25.19%	22.48%	22.20%	19.48%
% CRAR	27.43%	23.47%	25.70%	20.44%
% Net interest margin	8.54%	7.32%	7.73%	7.00%
% PAT / ATA	4.08%	2.13%	3.04%	-4.56%
% Return on net worth	19.90%	12.67%	18.45%	-32.93%
% Gross NPAs	1.48%	6.81%	1.18%	10.82%
% Net NPAs	0.58%	3.51%	0.36%	3.04%
% Provision coverage excl. technical write-offs	60.78%	50.31%	69.96%	74.15%
% Net NPA/ Core equity capital	2.62%	16.95%	1.74%	16.36%

Note: Amount in Rs. crore; All calculations are as per ICRA Research

Total assets and net worth exclude revaluation reserves

Quarterly results are unaudited; annual results are audited

Source: Bandhan Bank, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jul 2, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019	
					Nov 9, 2021	Feb 24, 2021	Aug 10, 2020	Nov 11, 2019	Mar 14, 2019 Jan 8, 2019	Oct 4, 2018 Apr 10, 2018
1	Subordinated Tier II NCD	Long Term	160.00	0.00	[ICRA]AA (Negative); reaffirmed and withdrawn	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA &	[ICRA]AA (Stable)
2	Term Loans from Banks*	Long Term	80.00	Nil	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA &	[ICRA]AA (Stable)
3	Certificates of Deposit	Short Term	3,000.00	1,131.94^	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Non-convertible Debenture Programme	Long Term	196.40	196.40	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable); Assigned	-	-
5	Non-convertible Debenture Programme	Long Term	-	-	-	[ICRA]AA (Stable); reaffirmed and withdrawn	[ICRA]AA (Stable)	[ICRA]AA (Stable); Assigned	-	-

* **Note:** The rating is yet to be allocated

^ Data as on July 2, 2021

Complexity level of the rated instruments

Instrument	Complexity Indicator
Subordinated Tier II NCD	Very Simple
NCD Programme	Very Simple
Term Loans from Banks	Not applicable
Certificates of Deposit	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs Crore)	Current Rating and Outlook
INE545U08019	Subordinated Tier II NCD	Sep-02-2014	14.536%	Sep-02-2021	160.0	[ICRA]AA (Negative); reaffirmed and withdrawn
NA	Term Loans from Banks*	NA	NA	NA	80.0	[ICRA]AA (Negative)
NA	Certificates of Deposit	NA	NA	7-365 days	3,000.0	[ICRA]A1+
INE580B07455	Non-convertible debentures^	Oct-30-2018	9.50%	Oct-30-2028	75.0	[ICRA]AA (Negative)
INE580B07489	Non-convertible debentures^	Nov-28-2018	9.18%	Mar-29-2022	86.4	[ICRA]AA (Negative)
INE580B07497	Non-convertible debentures^	Dec-06-2018	9.35%	Oct-31-2023	35.0	[ICRA]AA (Negative)

*Note: The rating is yet to be allocated; ^ These NCDs were transferred to BBL from erstwhile GRUH Finance Limited as a part of the amalgamation

Source: Bandhan Bank, ICRA research

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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